ATLANTIC HOUSE
INVESTMENTS

# Atlantic House Defined Returns Fund

## Quarterly Update

SEPTEMBER 2022

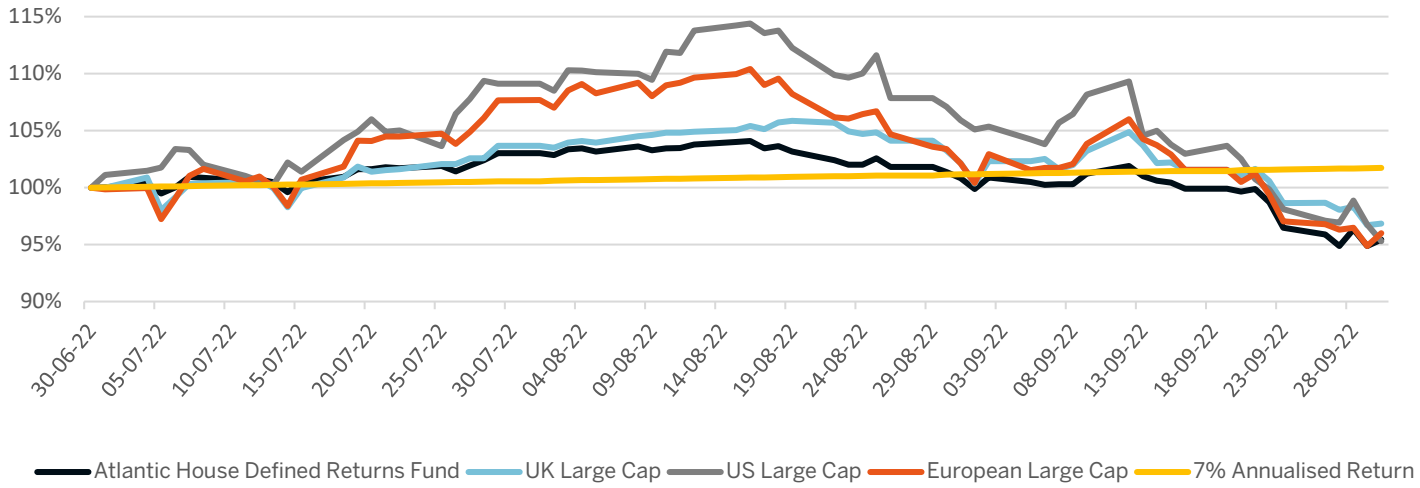
**Jim May, Co-Fund Manager of the Atlantic House Defined Returns Fund, provides an update on performance for the Fund in the quarter ending 30 September 2022.**

## Fund Performance[1]

### Past performance does not predict future returns

Like the first six months of 2022, Q3 saw a continuation of elevated volatility in global equity markets. High inflation figures across the globe, followed by central banks playing catch up with interest rate hikes has unsurprisingly dented equity markets again over the last six weeks of the quarter. The Russian invasion of Ukraine sadly continues and is a factor in world supply chain issues, exacerbating inflation. As you can see from the chart below, over the quarter the markets to which the Fund is mostly exposed (UK, US and EU) returned -3.2%, -4.7% and -4.0% respectively. The Fund returned -4.55% over the quarter, Since launch in November 2013, the Fund has delivered an annualised return of 5.34%.

### Cumulative Performance (%)




| Share Class/ Currency | 1 month | | 3 months | | 1 year | | 3 years | | | 5 years | | | Since Launch | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Perf. | Vol. | Perf. | Vol. | Perf. | Vol. | Perf. | Ann. | Vol. | Perf. | Ann. | Vol. | Perf. | Ann. | Vol. |
| B acc GBP | -5.33 | 13.76 | -4.55 | 10.30 | -4.94 | 10.72 | 6.12 | 2.00 | 19.88 | 20.37 | 3.78 | 16.14 | 58.92 | 5.34 | 13.97 |
| UK Large Cap | -5.18 | 16.17 | -3.15 | 14.40 | 1.87 | 16.56 | 3.80 | 1.25 | 20.82 | 13.81 | 2.62 | 17.68 | 44.49 | 4.22 | 16.14 |
| US Large Cap | -9.33 | 23.14 | -4.70 | 21.58 | -17.85 | 22.53 | 24.30 | 7.52 | 24.87 | 51.19 | 8.61 | 21.43 | 128.13 | 9.71 | 17.97 |
| EU Large Cap | -5.99 | 20.43 | -3.99 | 19.27 | -16.71 | 23.22 | -1.76 | -0.59 | 24.35 | 1.99 | 0.39 | 20.54 | 35.43 | 3.47 | 19.77 |

[1] Source : Atlantic House/Solactive. Performance of B share class, total return, net of fees in GBP. UK Large Cap: Solactive United Kingdom 100 Net Total Return Index, US Large Cap: Solactive US Large Cap Index and EU Large Cap: Solactive Euro 50 Net Total Return Index as at 30/09/2022. Fund launch: 4 November 2013.

The total delta as at the end of the quarter was 70.4% (up from 63% at the end of Q2). This increase is attributed to the falls in the UK, US and European markets. This means that one would expect, all else being equal, that the Fund's NAV would move by a little over two-thirds that of markets on a daily basis. If markets fall, the Fund's delta increases as the market levels get closer to the positive return barriers of the investments in the Fund, and vice versa if markets rise. As a reminder, an investment's positive return barrier is the level to which underlying indices can fall without impacting an investment's target defined return.

## Spotlight on Q3 Performance

The scenario analysis grid produced as of 30 June 2022 predicted that if markets were flat over the next three months, the Fund should rise by approximately 1.5%. And that if markets fell 10%, the Fund should fall around 5.7%. Markets were on average down around 4% for Q3, so we might have expected the Fund to be down around 1.4%. It actually fell 4.55%. The table and notes below explain both why the Fund fell as it did, and why in this three month period, the Fund "underperformed" the grid by just over 3%.

### Spot and volatility movements

The table below shows that the price and volatility movements of the indices to which the Fund is exposed had a combined impact on the return for the quarter of -3.7%.

| Index | Price move | 3 yr vol move | Price impact | Vol impact | Total |
|---|---|---|---|---|---|
| UK | -3.84% | 0.99 | -0.70% | -0.27% | -0.96% |
| US | -5.28% | 1.43 | -0.50% | -0.27% | -0.77% |
| Europe | -3.96% | 1.32 | -0.88% | -0.38% | -1.26% |
| US Mid | -2.53% | 0.72 | -0.05% | -0.02% | -0.07% |
| Japan | -1.73% | 0.56 | -0.07% | -0.03% | -0.10% |
| Asia | -21.21% | 1.37 | -0.39% | -0.01% | -0.40% |
| Swiss | -4.41% | 0.89 | -0.11% | -0.03% | -0.13% |
| Total | | | -2.69% | -1.00% | **-3.70%** |

### Rates

3 year sterling rates rose a whopping 2.78% over the quarter. The impact to the Fund was approximately **-2.30%.**

### Theta (time value of the investments)

As time ticks by, the puts that the Fund is inherently short decay in value which provides a tailwind to the NAV over time. The impact over the latest three month period was approximately **+1.75%.**

### Total

The sum total of the estimates above (-3.70%, -2.30% +1.75%) come to -4.25%. This is close to the actual fall the Fund experienced of -4.55%, so we are comfortable the models are doing their job. So why the discrepancy between the -1.4% predicted by the grid in June and the actual performance of -4.55%? It is because interest rates and volatility did not move in line with the assumptions made in June. When we create our grids, we have to make assumptions about interest rate and volatility levels in the future. To do this, we take the current implied "forward" rates for these parameters. If these forward rates do not move in line with these assumptions, it causes deviations from the grids. Between June and September, interest rates expectations rose significantly, as we all know. This had the effect of depressing the value of the investments in the Fund by more than the grids predicted – much as many bond funds will have performed poorly over the last quarter. This does not mean the grids are wrong, and in almost all cases they provide an excellent estimate of how the Defined Returns Fund might perform over time, but in times of extreme moves in volatility and rates that were not predicted (as we have seen this year), they are likely to be less accurate than in stabler times. For this reason, we have always, and will continue to, ask investors to give us some leeway regarding the scenario analysis grids.

## The Fund's relationship with gilts

As investors are likely to be aware, the lion's share of the Fund's cash is invested in UK gilts. The interest rate risk inherent in these gilts is mitigated through the use of interest rate swaps to create a "return of capital" layer within the Fund. Equity Index linked derivatives are then traded to deliver the "return on capital". As we will all be acutely aware, the price of gilts fell significantly following the new UK Government's mini budget on 23rd September. However, because the Fund has mitigated this risk through its use of interest rate swaps, it was insulated from the fall in gilt prices. In other words, the interest rate swaps increased in value by a similar amount to the decrease in gilt prices and therefore the fall in gilt prices did not affect the Fund overall. Furthermore, the Fund did not encounter the issue some pension funds had with meeting collateral calls. The Atlantic House Defined Returns Fund is the other way round - it has been calling for collateral from counterparties as the value of the interest rate swaps has increased. As an aside, we think we have a good understanding of what happened tin the LDI market, so please give us a call if you'd like to know what really happened, and why in the long run higher rates are good for DB schemes! Equally, if you'd like a refresher on how we use glts, please do get in contact.

## Portfolio Changes

We believe investors prefer us to take less risk while trying to achieve a 7% to 8% return over the long term, rather than chase higher returns. Given this, in a slightly perverse way, 2022 has been an excellent year for the Fund. Of the live investments within the Fund at the start of the year, almost 40% have matured and been rolled into new trades. Given heightened interest rates and volatility, the terms of these new investments have been as good or better than at any time in the Fund's almost nine-year existence.

A good way of observing how terms have evolved over time would be to look at a new investment traded this quarter, and then work back to see what maturing that investment replaced, and then carry on working back until the Fund launched. We do this below:

| Start date | 18-Jul-22 | 17-Jul-18 | 13-Apr-17 | 08-Aug-16 | 07-Mar-14 |
|---|---|---|---|---|---|
| Credit | Gilt | Gilt | Gilt | JPM | Gilt |
| Number of indices | 2 | 2 | 2 | 2 | 2 |
| Indices | UK / US | UK / US | UK / US | UK / US | UK / US |
| Potential Annual Return (simple) | 8.00% | 8.00% | 7.80% | 8.40% | 8.15% |
| Final positive return barrier | 64% | 71% | 75% | 75% | 75% |
| Protection barrier | 63% | 65% | 65% | 65% | 65% |

We think this is a neat way of not just showing how terms have changed, but also to highlight that we have aimed not to chase returns over the life of the Fund, and that has increasingly been the case. Targeting 7% to 8% with as little risk as possible has always been the aim, and that is what we will continue to do.

**It is also interesting to note that, despite markets falling significantly this year, by the end of Q3, the Fund's average cover to a positive return was 17.4% and the average cover to a capital loss was 25.6%.**

## Outlook

Earlier we focused on the scenario analysis table and how it can offer a good approximation of how the Fund might perform over time, but that it will not always be exactly accurate. Another data set we use is what we call the "Intrinsic Value" table. Here it is below, as at the end of September:

| Market Move | -30% | -20% | -10% | 0% | 10% | 20% | 30% |
|---|---|---|---|---|---|---|---|
| GRY (portfolio level) | -5.10% | 3.45% | 6.25% | 9.18% | 11.12% | 16.60% | 27.78% |
| Duration | 4.53 | 4.53 | 4.42 | 3.83 | 2.75 | 1.42 | 0.75 |

Source: Atlantic House as at 30/09/2022.

The table above is simply an estimate of the annualised returns the Fund would make, for different instantaneous market moves, if we were to simply let all the investments run to maturity. For example, it shows that if markets stay where they are, the terminal yield of the investments in the Fund would lead to an annualised return of 9.18% over the next 3.83 years. It also shows that the Fund is on track to deliver positive returns if markets fall a further 20% and do not recover. Given this, some investors believe now is a good time to be investing in the Fund given how uncertain the overall outlook is.

**The Fund's actual returns may differ from the projections shown and are subject to daily price movements. Future performance may also be subject to taxation, that could change in the future. The value of investments can go down as well as up and you may not get back the full amount invested.**

## Key Risks

**The Fund's actual returns may differ from the projections shown and are subject to daily price movements. Future performance may also be subject to taxation, that could change in the future. The value of investments can go down as well as up and you may not get back the full amount invested.**

This is a marketing communication. A final investment decision should not be contemplated until the risks are fully considered. A comprehensive list of risk factors is detailed in the Risk Warnings Section of the Prospectus and the Supplement of the Fund and in the relevant key investor information document (KIID). A copy of the English version of the Supplement, the Prospectus, and any other offering document and the KIID can be viewed at www.atlantichousegroup.com and www.geminicapital.ie. A summary of investor rights associated with an investment in the Fund is available in English at www.geminicapital.ie.

Calculations do not consider credit spread movements of the issuers of the securities. The Mark to Market of the securities and therefore the NAV of the Fund will decrease as credit spreads widen and vice versa if spreads narrow.

**The value of investments and income from them can go down and you may get back less than originally invested. There is no guarantee that the Fund will achieve its objective. The level and basis of tax is subject to change and will depend on individual circumstances.**

The Fund invests in derivatives for investment purposes, for efficient portfolio management and/ or to protect against exchange risks. Derivatives are highly sensitive to changes in the value of the asset from which their value is derived. A small movement in the value of the underlying asset can cause a large movement in the value of the derivative. This can increase the sizes of losses and gains, causing the value of a derivative investment to fluctuate and the Fund could lose more than the amount invested.

The Fund invests in high quality government and corporate bonds. All bonds will be rated at least A- by Standard and Poors at outset. If any of the bonds the Fund owns suffer credit events the performance of the Fund could be adversely affected.

Other risks the Fund is exposed to include but are not limited to, credit and counterparty risk, possible changes in exchange rates, interest rates and inflation, changing expectations of future market volatility, changing expectations of equity market correlation and changing dividend expectations.

A decision may be taken at any time to terminate the arrangements for the marketing of the Fund in any jurisdiction in which it is currently being marketed. Shareholders in affected EEA Member State will be notified of any decision marketing arrangements in advance and will be provided the opportunity to redeem their shareholding in the Company free of any charges or deductions for at least 30 working days from the date of such notification.

## Important information

Source for all data is Atlantic House Investments, Solactive and Bloomberg as at 30 September 2022, unless stated otherwise. Calendar year performance to 31 December each year.

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